

**Independent Review of Radio Spectrum Management
Submission by ITV and ITV Digital
August 2001**

This paper represents the views of the ITV companies and ITV Digital to the issues raised in the Radio Spectrum Management Review's consultation paper, published in June 2001.

ITV and ITV Digital's views were outlined in an initial submission to the review, attached as an appendix to this document. This supplementary submission focuses on areas where the consultation paper seeks further views or where clarification of the proposals in the consultation paper is sought. It concentrates on the paragraphs of the consultation document most relevant to broadcasting.

Overall we are supportive of the approach of the review and agree with much of the consultation paper. We welcome in particular the review team's acceptance that the key to optimising the efficient use of the broadcast spectrum is early digital switchover. We would encourage the review team to examine all means by which public policy can ensure efficient use of the broadcast spectrum through an acceleration of digital switchover.

The proposals for the broadcast spectrum contain several useful ideas with which we are in broad agreement. We welcome the acceptance that the disparity of treatment afforded to satellite and other broadcasters can and should be addressed and look forward to further details to how this might work in practice. We also support the ITC proposal to the review team that OFCOM be given flexibility to ease further Channel 3's licence payment regime to provide greater "incentives for specific and measurable further advances towards digital."

Introduction (paragraphs 1-7)

We welcome the review's clarity that maximising economic efficiency and the public benefit from broadcasting does not equate to maximising proceeds to the Exchequer. Efficient use of spectrum to deliver public policy outcomes and value to the public will not always be consistent with revenue maximisation. This applies in broadcasting – and public service broadcasting in particular – where there are a wide range of public policy objectives in play. These include the need for universally available services with high quality, locally produced output, the provision of which may be inconsistent with broadcasters paying the full opportunity cost of the spectrum they require. Looking forward, it is possible that alternative users might be prepared to make higher spectrum payments than terrestrial broadcast licence-holders for access to the same spectrum. But this does not indicate that broadcast licence holders are utilising that spectrum

inefficiently, nor that they should be expected to pay the “market rate”. The value to viewers of free to air television may be difficult to measure, but is significant. Free to air viewing is, after all, the UK’s most popular leisure activity.

Economic gains from efficient use of spectrum (paras 13-21)

We are not convinced that the Radiocommunications Agency data, reproduced in the consultation paper, paints an accurate picture of the economic impact of the broadcast spectrum.

Maximum efficiency is achieved where optimum value is derived from the radio spectrum. Value per MHz is therefore the key consideration. The consultation paper focuses on the less relevant ratios of value per licence fee and licence fee per spectrum. This has the effect of overstating the apparent disparity between the “efficiency” of broadcasting versus other users of spectrum, such as mobile telephony.

Further, although the RA has deployed fairly standard techniques in establishing the value of public service broadcasting to the public these techniques are inherently subject to the risk that they underestimate the true value of services provided free of charge to viewers. The same risks do not apply to other valuations where consumers make a payment for service, such as mobile telephony. Accordingly great care needs to be taken when comparing these valuations for the purpose of policy making (see below).

While the consultation paper separates out different forms of mobile telephony (2G, 3G and other) in assessing licence fees per MHz, broadcasters are treated together under a single heading. Analogue and digital broadcasting are not treated separately, even though – for clear public policy purposes – only analogue broadcasters currently pay any licence fees whatsoever. Likewise, the calculations include both the publicly owned analogue broadcasters – the BBC and Channel 4 – and commercial broadcasters – ITV and Channel 5. The BBC and Channel 4 make no payment for spectrum. ITV, on the other hand, pays dearly for its use of analogue frequencies, via licence payments, on top of its public service obligations. The different treatment of 3G mobile and broadcasting risks further overstating the disparity between the two in terms of economic return per spectrum. In particular for analogue ITV, which accounts for but a small portion of the broadcast spectrum, the gap with 3G is unduly exaggerated by the Radiocommunications Agency figures.

Furthermore, we are not convinced that the estimate of the reported “value” of broadcasting represents a full and fair assessment. The RCA data is based on the public’s reported willingness to pay for various services. However these responses are conditioned by the existing level of the licence fee and subscription

charges. There is a significant risk that these surveys merely disclose viewers' knowledge of the current level of the licence fee, rather than the actual value of the services to them. Furthermore, the RCA work takes no account of the wider public benefits provided by the public service broadcasting through network effects. We are confident that a fuller economic analysis would demonstrate that the estimates considerably understate the value of public service broadcasting.

These reservations would lead us to question whether – for broadcasting and ITV at least – there are “mismatches” as identified in the consultation paper and, if there are discrepancies, they are as “potentially serious” as the review team conclude. For ITV, we are confident that the mismatches are not as wide as suggested and any gap that remains is a simple corollary of its public service broadcasting role, rather than a problem per se.

Statutory basis of spectrum licensing (paras 28-31)

We have no objection in principle to the proposal to spectrum licensing moving from apparatus licensing to spectrum usage, if that produces a “technology neutral approach to spectrum management.” However we believe – as the consultation paper later concedes – that for those broadcasters which already make significant spectrum payments via licence fees, especially ITV, any shift in spectrum licensing must not increase (or “augment”) their existing licence fee burden. For these and other reasons, we believe that switchover remains the appropriate point at which to introduce any new licensing system for terrestrial broadcasters.

We support the review team's proposals to create a more level playing field between terrestrial and satellite broadcasters, in terms of regulation and their licence payment regime. We would welcome further details on how “regulation of signals transmitted from outside the UK (such as from satellites)” might be introduced and the associated charging regime. Ultimately, public service obligations on ITV are funded by advertising revenue and we find it odd that other broadcasters enjoy access to advertising revenues with no equivalent obligations being placed on them. In particular, BSkyB, which earns significant and increasing advertising revenues, makes no contribution to the Exchequer and no explicit public service provision to viewers.

Spectrum use: marketed and non-marketed outputs (paras 48-55)

We agree with the review team's view that broadcasting sits between the two extremes of marketed and non-marketed users of spectrum. Within the broadcast sector, individual broadcasters and platforms occupy different points

along this same continuum. ITV, for example, is a commercial public service broadcaster. It pays for its spectrum via licence fee payments and public service obligations. Non-public service commercial services, such as satellite channels, make no payments for spectrum – even though, as the review notes, one would expect “purely commercial” users of spectrum to be subject to spectrum pricing.

With a view to future spectrum management, the review may want to consider whether this anomaly should persist in the digital age. DTT and ITV Digital are subject to relatively onerous public service broadcasting requirements governing the services offered on DTT Multiplexes. There also exists the capacity for Government to introduce licence fees for DTT Multiplexes. Digital satellite is broadly outside the scope both of PSB regulation and the licence payment regime. The current licensing regime thus puts DTT and ITV Digital at a double disadvantage with respect to its prime competitor. We would regard this as all the more reason for introducing effective spectrum licensing for satellite as proposed by the review team. Alternatively - or in tandem with this process - the Government could confirm that, in reflection of DTT’s particular PSB role and obligations, the zero rating of DTT Multiplex revenues will be extended to the second licence term.

Broadcasting (paras 63-84)

ITV licence payments

The consultation paper’s breakdown of ITV licence payments – into franchise, “must carry” and public service obligations – overstates the value to ITV of must carry privileges. Must carry status for ITV is limited to digital cable. It is also accompanied by a “must offer” obligation on ITV as a reserved service. While ITV is not charged for cable carriage, it cannot charge cable companies for that carriage, as many other commercial channels are able to do. Must carry status on cable does not therefore represent an unambiguous economic benefit to ITV. (Indeed the legislative history shows that the cable operators were happy to have “must carry” in exchange for “free carry” inserted in the 1996 Act.)

ITV does not currently enjoy must carry status on digital satellite. Rather BSkyB has refused to carry ITV on digital satellite unless ITV agrees to pay a large (and potentially increasing) contribution to BSkyB’s network costs (over 10% of what BSkyB contributes to have its entire pay package of premium and basic channels carried). This would be in addition to the transponder costs and the direct costs of conditional access. BSkyB’s demands take no account of the benefit to the BSkyB platform of carrying ITV. This is an argument that ITV has advanced in the context of OFTEL’s review of the conditional access charging regime. It is also worth noting that, while the Government’s Communications White Paper proposes to ensure that ITV and other core PSB channels are available on all

digital platforms, it seeks to do this by introducing “must offer” obligations on channels like ITV, rather than extending “must carry”.

In sum, ITV’s must carry privileges are relatively restricted and of dubious economic value to the channel. The corollary of this is that an even higher proportion of ITV’s licence payments represents payment for a franchise, which is dependent on semi-exclusive access to the analogue broadcast spectrum. “Unbundling” the ITV licence fee, insofar as it is possible, therefore demonstrates that ITV licensees already pay handsomely for their access to the analogue spectrum.

ITV welcomes the confirmation that introduction of an explicit “spectrum fee” would not mean “double jeopardy” for ITV licence holders. In order to preserve the digital dividend system and the incentives to spectrum efficiency this entails, we would recommend that any spectrum fee for ITV could most effectively be introduced after completion of digital switchover. In advance of switchover, together with its transmission contractor, ITV is ready to consider any initiatives to increase efficient use of the analogue spectrum consistent with maintaining its analogue coverage. ITV would expect any advances possible on this front to be factored into the price it pays for transmission. In this sense, incentives for analogue spectrum efficiency already exist.

ITV would not oppose the introduction of an explicit spectrum fee or licence payment for the BBC and Channel 4. The BBC is amply funded to be able to afford to pay for its spectrum. Given its significantly increased income since the end of the funding formula (worth over £100 million per annum), the justification for Channel 4 benefiting from free spectrum is considerably weakened. For both broadcasters, introducing spectrum charges would give substance to their claimed independence from direct Government subsidy.

Broadcasting (paras 63-84)

Switchover

We agree that the key prize in terms of greater spectrum efficiency in broadcasting is digital switchover, which will end simulcasting on both analogue and digital frequencies and allow a greater number of broadcast services to be offered to free-to-air and pay-TV terrestrial viewers.

The review team states that it will consider the extent to which spectrum management can contribute to the implementation of the switchover strategy. We would encourage the team to consider all possible mechanisms as set out in ITV’s original submission. Digital switchover will crucially depend on the continued success of DTT, which in turn would be boosted by improved DTT coverage; increased DTT capacity; EU level action to encourage or mandate

production of 'dual capable' television sets; and more effective promotion of digital television. Given the decision to dedicate frequencies to DTT and its indispensability to switchover, it is essential that DTT's reach is expanded.

The review claims that there are "few financial incentives on incumbent terrestrial broadcasters to economise on current spectrum usage" and that there is a lack of "clear incentives for broadcasters to consider the longer-term trade-offs between terrestrial analogue and digital transmission. For ITV, there is a limited incentive in the form of the digital dividend. However this may prove insufficient to encourage investment in full DTT transmission coverage or migrating analogue diehards to digital.

ITV therefore supports the ITC's proposal to the review team that OFCOM should be given "greater flexibility" to vary Channel 3 licence payments "to give incentives for specific and measurable further advances towards digital." As the ITC states, the regulator could offer additional licence fee reductions in return for further investment by ITV in the digital transmission network or its participation in an industry-led scheme for cheap set top boxes.

The disparity between ITV's incentive to promote digital and other terrestrial channels more mixed incentives may serve to undermine efforts to promote digital and DTT in particular. While Channel 4 and Channel 5 received gifted DTT capacity, they gain little from increasing the pace of digital switchover. C4 and C5 will lose significant advertising share as the audience migrates to digital. Unlike ITV, these broadcasters receive no counterbalancing digital dividend, because they do not make revenue dependent licence payments. Government should ensure that all broadcasters in the UK market should face incentives to promote digital take up.

Post-switchover

The review pledges to examine "applying incentives towards spectrum efficiency after digital switchover". In international terms, UK DTT is a hugely efficient user of spectrum: it is up and running, all multiplexes are approaching capacity, and less spectrum has been earmarked than in other countries. Furthermore, DTT serves an indispensable public policy end in ensuring comprehensive digital coverage and guaranteeing affordable digital access for free-to-air households. It is also the most regulated digital platform in PSB terms. Because of its constraints in terms of capacity, DTT is in effect self-regulating in terms of spectrum efficiency. The Mux operators – especially ITV Digital – have a massive incentive to ensure that multiplex capacity is used as efficiently as possible to minimise the capacity imbalance with digital cable and satellite.

For all these reasons, incentives for spectrum efficiency on DTT post-switchover should not be conceived of in terms of the platform's ability to generate

spectrum fees. Depending on the profile of digital take-up, it is possible DTT Multiplexes may not be able to generate revenues to cover licence payments that alternative users of the same spectrum might be prepared to pay. This is no argument for more onerous licence payments or the alternative deployment of the DTT spectrum.

The review confirms that it "will not investigate charging for DTT spectrum use up to the point of analogue digital switchover," because of "the dramatic improvement in spectrum efficiency" that will be yielded at that time. According to the 1996 Act, the process of renewal of the DTT Multiplex licences may begin as early as 2006. Renewal terms may therefore be set in advance of switchover. If the review team accepts that DTT spectrum should not be charged for until switchover at the earliest, confirmation that DTT Multiplex revenues will be zero-rated at least to that point would be useful as early as possible.

Appendix 1
Radio Spectrum Management Review
Submission by ITV and ONdigital
May 2001

Key recommendations

- Spectrum efficiency should not prejudice separate questions over the different uses to which radio spectrum should be dedicated.
- Spectrum pricing should take full account of the public service broadcasting obligations of ITV and other analogue terrestrial channels
- The main ITV companies' massive investment in ONdigital and DTT should be reflected in the pricing of their access to the radio spectrum.
- To allay market concerns, confirmation should be given that
 - existing licence payments regimes for ITV and DTT will remain in force for the current terms of their licences;
 - the digital dividend system in place for ITV licensees since the 1996 Act will run its full course; and
 - the introduction of spectrum pricing for broadcasting will not occur before digital switchover.
- Any additional payments for spectrum licences for ITV should occur after switchover or be "netted" off existing licence payments.
- Rapid digital switchover should be confirmed as the key priority to maximising spectrum efficiency for broadcasting.
- DTT's role in helping achieve early switchover should be reaffirmed, along with ONdigital's importance in ensuring DTT's success. DTT's many wider public benefits should also be restated.
- To encourage further DTT investment and achieve switchover, consideration should be given to extending the zero rating of multiplex revenues to the second term of DTT licences.
- Practical steps should be accelerated to improve DTT coverage and roll out and reduce DTT's capacity and reach imbalance with competitor platforms.

- Confirmation should be offered that post switchover, the case for a broadcasting super-tax is considerably weakened and that any such tax will need to be platform neutral.

Radio Spectrum Management Review
Submission by ITV and ONdigital
May 2001

This preliminary submission to the Radio Spectrum Management Review represents the combined view of the ITV Network and ONdigital, following an initial meeting with the spectrum review team in May 2001.

Introduction

The radio spectrum represents a valuable and limited national resource, with an increasingly wide range of uses. Air traffic control, the emergency services, national defence, navigation and radar devices, mobile telephony, telecommunications, national and local broadcasting, programme making and emerging convergent technologies – all require access to the radio spectrum, often on an exclusive or semi-exclusive basis. The efficient management of the radio spectrum is therefore rightly a public priority.

The spectrum management review is tasked with devising a framework to ensure that all users of spectrum “are focussed on using their spectrum as efficiently as possible.” ITV supports the goal of optimising spectrum efficiency, but also recognises its limitations as a guide to policy. Spectrum efficiency dictates that minimum spectrum necessary is used to deliver a given end. However it will not tell us what those ends should be. It is clear that all users of spectrum should be incentivised to use no more spectrum than they require. But this does not mean that spectrum efficiency is the relevant yardstick for determining to which of various potential uses the radio spectrum should be dedicated. National defence may require large swathes of spectrum, a fraction of which might be able to deliver mobile communications services. But this should not imply that spectrum should be turned over from national defence to mobile operators in the name of “efficiency”.

Likewise spectrum pricing may optimise “efficiency”, but should not itself be the prime method of allocating spectrum between various uses. The price for spectrum cannot be isolated from the use to which it is put. Non-commercial users of spectrum may not be able to pay the price commercial users of the same spectrum might be willing to pay. The benefits delivered by use of spectrum for navigation or national defence may be impossible to quantify in economic terms. Even amongst commercial users of spectrum, the price different categories of user may be able to pay may vary widely. The value of spectrum to broadcasters may not match that for telecoms operators, for example. However those same broadcasters may deliver additional public benefits, in terms of content or service standards, the value of which is significant, though difficult to “price”. Conversely, demanding from such operators the “market price” may jeopardise their ability to deliver those broader public goods. Public service broadcasting

investment could be “crowded out” if broadcasters are expected to deliver high licence payments. Reserving as much spectrum as possible for those sectors able to pay the highest price will be efficient only in the narrowest economic sense.

The efficient management of the radio spectrum must therefore start with an analysis of the wider public benefits delivered by particular uses of spectrum. ITV is confident that any such analysis would demonstrate that terrestrial broadcasting – public service and commercial – delivers full value for the spectrum it uses. ITV in particular delivers a double benefit of over £300 million per year to the public purse in licence fees together with significant public service broadcasting obligations. These include the biggest single channel programming spend in the UK, regional investment worth £200 million per year, plus news and a range and diversity of other key public service programming categories.

Historically terrestrial public service broadcasting has relied on analogue transmission. The launch of Digital Terrestrial Television and ONdigital has allowed the shift to begin to more efficient digital transmission. Equivalent radio spectrum will be able to deliver over six times more channels, plus interactive and text services, allowing enhanced digital transmission of the established five channels, plus new free to air and pay channels. Exciting new services, such as the delivery of public services via interactive TV, will also be possible using digital television. The shift to digital broadcasting and the switching off of the analogue signal will therefore be more spectrum efficient, preserve the public benefits delivered by the existing analogue free to air services and supplement it with new public benefits. For these reasons management of the radio spectrum deployed for broadcasting should focus on accelerating digital switchover.

It is more difficult at this point to determine the principles that should guide spectrum management beyond switchover. Much will depend on market developments over the next several years. The Government has expressed its support for a tripartite digital ecology with three competing digital platforms – digital cable, digital satellite and DTT. ITV is convinced that switchover will require a strong and vibrant DTT platform in particular. In a three platform ecology and with investment in DTT running at over three times forecast, it is clear that Government cannot look to digital terrestrial broadcasting to deliver the sorts of sums to the Exchequer that a single analogue terrestrial broadcaster, ITV, has delivered in the recent past. Extending the zero rating of DTT revenues into the second licence term would encourage greater investment in DTT and reflect the significant unforeseen additional investment required in DTT roll out to date. In a world beyond spectrum scarcity and of competing platforms, it is difficult to see the logic of anything beyond only a significantly reduced and platform neutral licence payment system. In the longer term, beyond the second DTT multiplex licence periods, any future decision over whether the radio spectrum should continue to be dedicated to existing or new DTT multiplexes

should not be based solely on the platform's ability to generate a return for the public purse.

Current payment regime

ITV licencees currently pay significant annual payments for their analogue licences – totalling £350 million in 2000. Though technically not spectrum licences, the ITV licences carry with them privileged access to the analogue spectrum for which licensees are effectively paying. The financial terms for the licences were originally based on the terms set in the 1991 franchise round. However, all licences have now been renewed on the basis of new financial terms set by the regulator. The renewal process involved an assessment of the worth of the analogue licence over the next ten years. The new licences run until 2008-11.

ITV licence payments are made up of an index linked annual cash payment and a payment based on a set Percentage of Qualifying Revenue (PQR) from advertising and sponsorship. Anglia Television, for example, pays an annual cash bid of £3.42 million and 17% of its PQR, equivalent to a further £20+ million per year. Following the licence renewal process, the PQR payments make up the majority of ITV's licence payments.

The licence payment regime for digital terrestrial television is different from that for analogue. DTT channel licences – Digital Programme Service Licences – are issued on application and carry only minimal administrative licence fees. The relevant licence for broadcasting tax purposes is that held by the multiplex provider, rather than the individual channel. ITV and other public service broadcasters have been awarded multiplex capacity for their core services and new digital services. ITV's multiplex capacity is held by Digital 3&4, co-owned by ITV and Channel 4. ONdigital holds the licences for a further three commercial multiplexes. All multiplexes licences run for a renewable 12 year term. For the first term, the licence payments for all multiplexes have been waived by Government in order to encourage take up of digital television.

While DTT Multiplex revenues are zero rated, revenues from digital cable and digital satellite fall outside the scope of taxable qualifying revenue. Effectively ITV pays no variable tax on its digital revenues. ITV licensees are therefore entitled to a rebate on PQR paid for every digital viewer. The transition to digital is therefore easing ITV's licence payment regime significantly. On the current arrangements, when the whole population has turned to digital, ITV's licence payments will be made up only of its cash payments, with PQR reducing to zero. This would represent a total payment for ITV of £65 million on last year's figures, rather than the £350 million currently paid.

This steep decline in ITV's licence payments reflects the fact that the value of ITV's privileged access to the analogue spectrum will have reduced massively with the transition to digital. But even at switchover, on current arrangements, ITV would be paying significantly more than Channel 5, which pays just £24 million per year for its licence. No other UK commercial channel, Channel 4 included, make any payments for their broadcast licences. The BBC makes no licence payments, even though it benefits from double ITV's capacity in analogue and digital, on top of £2.3 billion of licence fee subsidy.

Spectrum valuation

The Radio Spectrum Management Review will address issues of spectrum management across the board. According to the terms of its remit, the review will "advise on the principles that should underlie spectrum management and what more can be done to ensure that all users, including non-commercial users, are focused on using their spectrum as efficiently as possible."¹ As a first stage, the review will investigate:

- "means of ensuring that all of the spectrum, including that allocated to non-commercial purposes, is used with maximum efficiency; and
- investigating the scope for improving spectrum pricing and trading arrangements."

The Radio Spectrum Management Review may also involve a preliminary spectrum valuation exercise. However the white paper also pledged that the "spectrum used by broadcasters should be valued" in what ITV understands will be an exercise separate from the review, conducted by the Radiocommunications Agency.

When assessing "the extent to which payment is required for use of this spectrum", the valuation exercise will explicitly "take account of the particular circumstances of broadcasting." The white paper goes on that these include:

"the substantial payments already made under the Broadcasting Acts by commercial broadcasters; the level of public service obligations undertaken by the broadcasters; and the forthcoming switchover to digital broadcasting."²

Even without taking into account the significant public service broadcasting obligations on ITV companies, it is by no means clear that a valuation of the broadcast spectrum currently occupied by ITV would lead to upward pressure on

¹ *Economic and Fiscal Strategy Report and Financial Statement and Budget Report*, March 2001, para 3.44

² *A New Future for Communications*, DTI/DCMS, December 2000, para 2.7

existing licence payments. A recent independent estimate of the worth of the analogue spectrum occupied by UK free-to-air broadcasters, *pro-rata to the UK 3G auction*, puts it at £10 billion.³ Given the less impressive results of the broadband fixed wireless auction – the Government raised £38 million against a target of £1 billion – this is likely to be at the very upper end of valuations. The analogue broadcast spectrum is currently occupied by four broadcasters and five channels – ITV occupies only a portion of the analogue spectrum. The 3G spectrum licences were for 20 years. The ITV licensees paid over £350 million in licence payments in 2000 alone. Over 20 years at this rate ITV would pay over £7 billion for access to a fraction of the analogue broadcast spectrum. This contrasts with Channel 4 and the BBC, who pay nothing for their access to comparable (or greater) amounts of spectrum.

On top of licence payments, ITV makes a significant investment in meeting its public service broadcasting obligations. ITV has the largest programme budget for national and regional programmes of any single UK channel, including BBC1. The majority of this spending funds original production, with the majority of that investment going outside London to the UK regions. ITV employs over 8,000 staff in production and broadcasting nationwide. The ITV companies spend around £200 million on regional programming and around £40 million on news per annum. There is also the significant opportunity cost from dedicating schedule slots to regional programming, rather than network programmes likely to attract higher advertising revenues. As competition increases, the costs represented by these public service broadcasting obligations - and the reduced scheduling flexibility they imply - becomes more onerous. Taking into the full costs of public service broadcasting investment as well as licence payments, a valuation of the broadcast spectrum could demonstrate that ITV is actually paying over the odds for its spectrum.

Any valuation of the radio spectrum in the round would also need to take into account the significant investment by the ITV companies, Carlton and Granada, in ONdigital and DTT. Carlton and Granada are on course to invest £1.1 billion in ONdigital – over three times originally forecast peak funding of £300 million. The extra investment is largely due to the fact that ITC's projections for DTT coverage have not been met. While targeting ONdigital, this investment is helping to build the UK's DTT infrastructure and a competitor to the established satellite and cable platforms, with the important difference that the DTT platform is 'open' in nature and equally available to the three 'gifted' multiplex owners as it is to ONdigital.

DTT revenues are zero rated for tax purposes. However the licence payment system does not take account of the significant and unforeseen additional investment in ONdigital. The digital dividend for ITV's licence payments does not discriminate between DTT and digital cable and satellite. Next year, Carlton and

³ *The analogue TV spectrum switch-off in the UK*, Enders Analysis, December 2000, page 2

Granada will enjoy a larger digital dividend from ITV's carriage on digital satellite than from DTT – despite their massive investment in the latter.

ITV licence payments

ITV supports the goal of spectrum efficiency and the role of the Radio Spectrum Management Review in achieving this end. ITV is also confident that it is not the intention of the review to re-open the existing licence settlement either for regional ITV licences or for DTT Multiplex licence holders. ITV understands that the prime focus of the review, insofar as it covers broadcasting, will be with the process of digital switchover and the principles that will govern licensing for broadcast users of the radio spectrum post digital switchover.

However a number of commentators have expressed the view that the spectrum review presages an attempt by Government to reopen the licence payment settlement and introduce a new "spectrum tax".⁴ Market analysts have also expressed concern that Government might renege of the so-called "digital dividend" set out in the 1996 Act and re-affirmed in the current licence renewal round.

ITV takes it as read that the existing settlement for licence payments for both ITV and DTT should and will be honoured. The settlement has been in place since 1996. ITV companies have been prepared to make significant licence payments thus far based of the prospect of lower payments in subsequent years. Licences have just been renewed on financial terms presupposing the current arrangements. ONdigital will invest three times more than its original business plan in DTT. These and many other considerations would make any shifting of the goal-posts now unthinkable.

We hope that the review will seek to clarify its role and remit. In the issues paper or subsequent publications, the review could usefully confirm that its work is based on the following assumptions:

- i) that existing licence payments regimes for ITV and DTT will remain in force for the current terms of their licences;
- ii) that the digital dividend system in place for ITV licensees since the 1996 Act will run its full course; and
- iii) that the introduction of spectrum pricing for broadcasting will not occur before digital switchover.

⁴ See inter alia: *Government White Paper on Broadcasting*, SSSB, December 2000; *ITV*, CSFB, March 2001; *ITV Licence Fee Update*, ABN AMRO, March 2001

Each of these statements is consistent with previously stated policy and the paragraphs in the White Paper on spectrum management. Clarification along these lines would provide useful reassurance that the review is not the vehicle for a pre-switchover change to the broadcasting licence payment regime.

There has also been speculation that the Government will seek to impose specific payments for spectrum as a way of “introducing” spectrum pricing for broadcasting. The aim of this would be to standardise spectrum pricing and licensing across different sectors, rather than raise additional revenues. However, because of the current licence settlement, any increased payments for spectrum licences would need to be deducted from ITV’s existing licence payments to leave the net tax burden unchanged. This would be consistent with Radiocommunications Agency policy that:

“Existing operators will not be required to enter a spectrum auction for the right to continue their existing services within existing allocations. Nor will broadcasters who have won their broadcasting franchises in an auction under the broadcasting legislation be required to enter a spectrum auction.”⁵

The alternative would be to wait until subsequent licence periods or digital switchover before countenancing even cosmetic changes to licence payments. ITV’s view remains that digital switchover represents the natural juncture for any such adjustments to be considered in the light of ITV’s enduring public service broadcasting role.

Spectrum efficiency and digital switchover

In the context of broadcasting, spectrum efficiency is ineluctably linked to the process of digital switchover. Digital terrestrial broadcasting in the UK has been a world’s first. DTT multiplexes occupy previously unused or under-exploited frequencies. Equivalent spectrum to that currently required by the five analogue free to air channels provides capacity for six DTT multiplexes, each capable of providing at least six television channels, plus text and interactive services. As well as the five free to air channels, which are all simulcast on DTT, a wide range of free, subscription and pay per view services are provided by ONdigital and the other multiplex operators.

After digital switchover, the existing free to air channels will no longer need to be simulcast in analogue as well as digital. The spectrum currently used for analogue broadcasting can be made available for new uses, from further DTT multiplexes to mobile telephony and new applications. However, mixed occupancy of spectrum, such as mobile phone and DTT, will reduce efficiencies

⁵ *Spectrum Pricing: Implementing the Third Stage*, Radiocommunications Agency, 1999, para 4.18

because of the restrictions placed on optimum frequency planning due to the significant differences in transmission power and channel occupancy profiles between the two types of service. Estimates of the value of this spectrum run as high as £10 billion. The key to the efficient use of the broadcast spectrum is therefore rapid digital switchover. Any measures which advance digital switchover will also help achieve greater spectrum efficiency.

Of course, digital switchover offers far more than improved spectrum efficiency. Digital television promises the potential for a whole raft of new digital and interactive services – from email to online public services – to be opened up to the population at large. Digital television will allow the “digital divide” to be bridged and enable the delivery of important Government objectives, such as universal email and Internet access by 2005.

DTT uniquely offers the potential for free to air viewers to convert to digital television, without a satellite dish, cable or subscription. With an integrated digital TV set, the viewer can watch up to 15 free-to-air channels, including the terrestrial five and new services from the BBC and ITV. Uniquely in the DTT environment, no subscription to any pay-TV operator is required. DTT also has advantages over both cable and satellite in terms of its ability to reach portable and mobile televisions, which make up a high proportion of additional television sets in many UK households. Reaching those viewers not attracted to pay-TV and resolving the “second sets” issue are two of the largest challenges to be met if digital switchover is to be reached on the 2006-10 timetable announced by Government. On both these counts, DTT will be crucial to switchover.

The success of DTT is in turn contingent on that of ONdigital. Over 99% of DTT viewers are currently ONdigital subscribers, attracted to the platform by ONdigital subsidy of set-top boxes: Much of ONdigital's investment - in marketing, in public information, in integrated digital TV sets - is helping to establish DTT as a viable platform. Without such a strong commercial driver of DTT, digital switchover on the ambitious timetable envisaged by Government will simply not be possible. Support for DTT and ONdigital therefore provides indirect support for early switchover and the greater spectrum efficiency and wider public benefits that will deliver.

While ONdigital has achieved its first million subscribers in record time, ONdigital and DTT have faced formidable and largely unpredicted challenges. DTT is only now on the verge of reaching the 70% of the country which the ITC forecast coverage would have reached over two years ago. In reality, *effective* coverage is still lower than 50%, with many parts of the country supposedly covered, but subject to reception problems. Subscribers in these areas tend to “churn” out of subscription. Such reception problems are in part caused by the need to ensure the analogue signal is not degraded by the digital signal. Progress has been made, most recently with a modest (3dB) power increase announced for eight

digital transmitters; although we believe further power increases are feasible without significant damage to analogue reception.

Coverage and reception problems have added significantly to digital roll out and subscriber acquisition costs. To maintain target subscriber growth despite reduced coverage, ONdigital has had to increase investment in content, marketing, and subsidies for set top boxes and integrated digital TV sets. Continuing high wholesale prices demanded by premium channel suppliers have also led to increased knock on costs. Peak funding for ONdigital alone is set to reach £1.1 billion, compared to original plans of £300 million. Other multiplex operators are also investing heavily.

Digital switchover will only occur when digital coverage is near universal. Given the significant additional expenditure in DTT required to date, consideration needs to be given to ways of incentivising DTT operators to undertake the further spending required to extend DTT coverage beyond the currently planned 70% of the country. It may soon be appropriate to indicate the basis for renewal and anticipated level of taxation on multiplex revenues for the second multiplex licence terms. The 1996 Act suggests that multiplex licence renewal will be a straightforward process. The process for determining licence payments, if imposed, in subsequent licence periods is less certain. Any complications to the process of licence renewal or a significantly raised tax rate in the second term could threaten continued investment in DTT. Licence holders will be less inclined to invest in extending coverage if the return will only come in subsequent licence periods, when they may not hold the licence or would be subject to a more onerous tax regime. By contrast, confirmation of the renewal process and extension of the zero rating of multiplex revenues into the next licence period would strengthen the resolve of multiplex operators to continue to invest further in DTT.

Certainty over the longer term licensing regime for DTT needs to be accompanied by more immediate moves to increase DTT coverage and early digital switchover, including the following measures:

- ***Harmonised frequency planning across Europe.***

Efficient use of UHF Bands 4&5 requires harmonised frequency planning with the UK European neighbours, a process overseen by the International Telecommunication Union. The ITU timetable for review of international frequency planning parameters, which envisages "policy" emerging in 2006, needs to be accelerated to allow early switchover in the UK.

- ***Restrictive Service Licenses***

It will soon be possible to accommodate RSLs and local DTT via regional and sub-regional multiplexes. This makes far better economic sense than awarding a whole UHF channel to an RSL operator.

- ***Analogue transmitter build***

Currently, the ITC Code of Practice requires analogue reception to be restored to viewers if it is wiped out by DTT. In a number of cases, this has required building a new analogue relay. Clearly it does not make sense to build more analogue sites with an ever-shorter lifespan and which will make future switchover harder.

- ***Analogue protection***

Current experience in the UK indicates that the restrictions on DTT power imposed to protect existing analogue transmissions may be too conservative. Effective reception for portable TVs in particular will require a more robust digital signal. A review of analogue protection levels is now required in order to speed up the transition to switchover and encourage spectrum efficiency.

- ***Analogue NICAM***

NICAM occupies space in adjacent UHF channels. Protection of NICAM in adjacent analogue channels can place technical restrictions on DTT implementation if the use of frequency offsets is not allowed. Levels of protection should be reconsidered if more DTT channels are required.

Investment in DTT may be hampered by uncertainty over long-term frequency allocations. Broadcasters will not want to commit investment if significant realignments of spectrum are likely before or at switchover. More coherent, long-term frequency planning – rather than the current piecemeal approach - could also help maximise further spectrum releases to DTT or other uses. This is one area where a Ministerial “digital champion” could take a lead.

Releasing further spectrum to DTT could help improve coverage and reduce the capacity imbalance with cable and satellite. The ITC Chief Executive Patricia Hodgson has recently claimed that confirmation of current digital spectrum use could lead to early release of spectrum equivalent to over half ONdigital's current capacity.⁶ In fact, the suitability of this spectrum for DTT broadcasting may be problematic. However if additional spectrum can be found from this or other sources to expand DTT capacity, improve coverage and add channels and interactive services, it would provide a powerful boost to DTT and the prospects for early digital switchover.

⁶ *Commerce and Culture*, ITN EMF lecture, Patricia Hodgson, February 2001

Spectrum management post-switchover

Setting the framework for spectrum management beyond digital switchover is difficult with so much uncertainty remaining over the pace and nature of the digital transition. Much will depend on market developments over the next several years. However some preliminary observations are possible.

The licensing and licence payment regime for broadcasting in the past has been based on monopoly access to scarce spectrum. Licence payments were originally introduced to prevent the ITV companies making excessive profits in a market where they enjoyed privileged access to the terrestrial spectrum which represented the sole route to the vast majority of homes. This monopoly has now been eroded on two fronts. ITV is now only one of three commercial channels with access to analogue terrestrial homes. As importantly, the analogue spectrum no longer represents the sole, or even the *prime*, route to a growing proportion of UK homes. Beyond spectrum scarcity and with a plurality of broadcast platforms, the justification for a super tax on ITV or terrestrial broadcasting generally is considerably weakened.

An enduring super tax on broadcasting also faces formidable practical difficulties. Of the three digital platforms, only DTT spectrum is in Government's gift and straightforwardly taxable. The Government has thus far waived digital multiplex payments to encourage the roll-out of DTT, but could introduce licence payments for the next licence period. If introduced, multiplex licence payments will inevitably be borne either by DTT channel or the subscriber. For channels, given DTT's subscriber base, significant licence payments could encourage withdrawal from the DTT platform and broadcasting only via digital satellite and cable to which a spectrum tax cannot currently be applied. For viewers, any increase in subscription implied by multiplex licence payments would be a disincentive to going digital. Raising significant sums from the multiplexes implies large payments per DTT viewer. If ONdigital reaches five million households, each would have to pay well over £70 per annum as part of their subscriptions to generate licence payments equivalent to that currently paid by analogue broadcasters. A tax at this level would put DTT at a significant disadvantage to cable and satellite and be difficult to reconcile with the Government's stated policy of platform neutrality. Any licence payments on DTT multiplexes would therefore have to be much more modest to be practicable. Post-switchover a broadcasting super tax may need to be platform neutral if it is to be imposed at all.

For ITV, it is even more difficult to see how Government could impose a post-switchover spectrum tax that could stick and raise significant sums. Post-switchover, ITV will no longer enjoy privileged access to Government-gifted spectrum guaranteeing universal availability in every UK household. Government-granted DTT spectrum may only provide ITV with access to a

minority of households. Even if Government provides ITV with “must carry” at incremental or zero cost on other platforms, the value of this privilege may be limited. Many other channels are likely to be universally available on all digital platforms. Even today, for example, Sky One is available on DTT, D-Sat and digital cable, for which it effectively makes no licence payments.

With a greater number of universal and free-to-air competitors – not to mention subscription channels - imposing an additional spectrum tax on public service broadcasters will only undermine their competitiveness. If channels like ITV in addition face continuing and expensive public service commitments (e.g. regional service obligations), the clear risk is that these channels decide that limited public service privileges are not worth the content and tax obligations. Individual programmes – or indeed the whole service – could migrate to other universally available or subscription channels which do not face a special tax or content regime.

Indeed, even without a special spectrum tax, the balance between public service obligations and privileges is likely to be a delicate one. For ITV, full digital transmission will imply significant additional costs from the need to replicate ITV’s regional services on digital satellite in particular. ITV is already required by the ITC to provide 16 regional variants on digital satellite, with each effectively requiring a dedicated channel and the associated digital spectrum. This cost may rise over time, if further sub-regional services are to be replicated on digital satellite. These costs are quite separate from additional conditional access fees, that ITV may have to pay if meaningful must carry is not to be introduced. Rather than a new spectrum tax, it may make more sense for Government to consider a **lighter** tax regime for those channels with enduring public service obligations, compared to those without. At the extreme, some form of public subsidy for those channels still prepared to honour public service broadcasting obligations could be envisaged.

Using DTT or ITV access to DTT spectrum as the Government’s means of continuing a broadcasting super tax post-switchover is therefore fraught with difficulty. But digital terrestrial’s possible limitations as a revenue generator for Government should not be viewed as an argument against DTT’s use of radio spectrum on an ongoing basis. DTT will deliver far more than licence payments, including a competitive digital ecology, a bridged digital divide, enhanced choice and new interactive services and the prospect of digital public services delivered to every home in the country. Beyond the second 12 year DTT multiplex licence periods, any future decision over whether the radio spectrum should continue to be dedicated to existing or new DTT multiplexes should not be based solely on the platform’s ability to generate a return for the public purse. The many wider public benefits DTT provides must also be taken fully into account.